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Brief of Cochran for D. Def.

Supreme Court of the United States.

OCTOBER TERM, 1900.

Filed Jan. 31, 1901.

No. 179.

CALVIN HOOD, *Plaintiff in Error*,

vs.

T. B. WALLACE, as Receiver of the Missouri National Bank of Kansas City,

Defendant in Error.

No. 180.

C. J. LANTRY, *Plaintiff in Error*,

vs.

T. B. WALLACE, as Receiver of the Missouri National Bank of Kansas City,

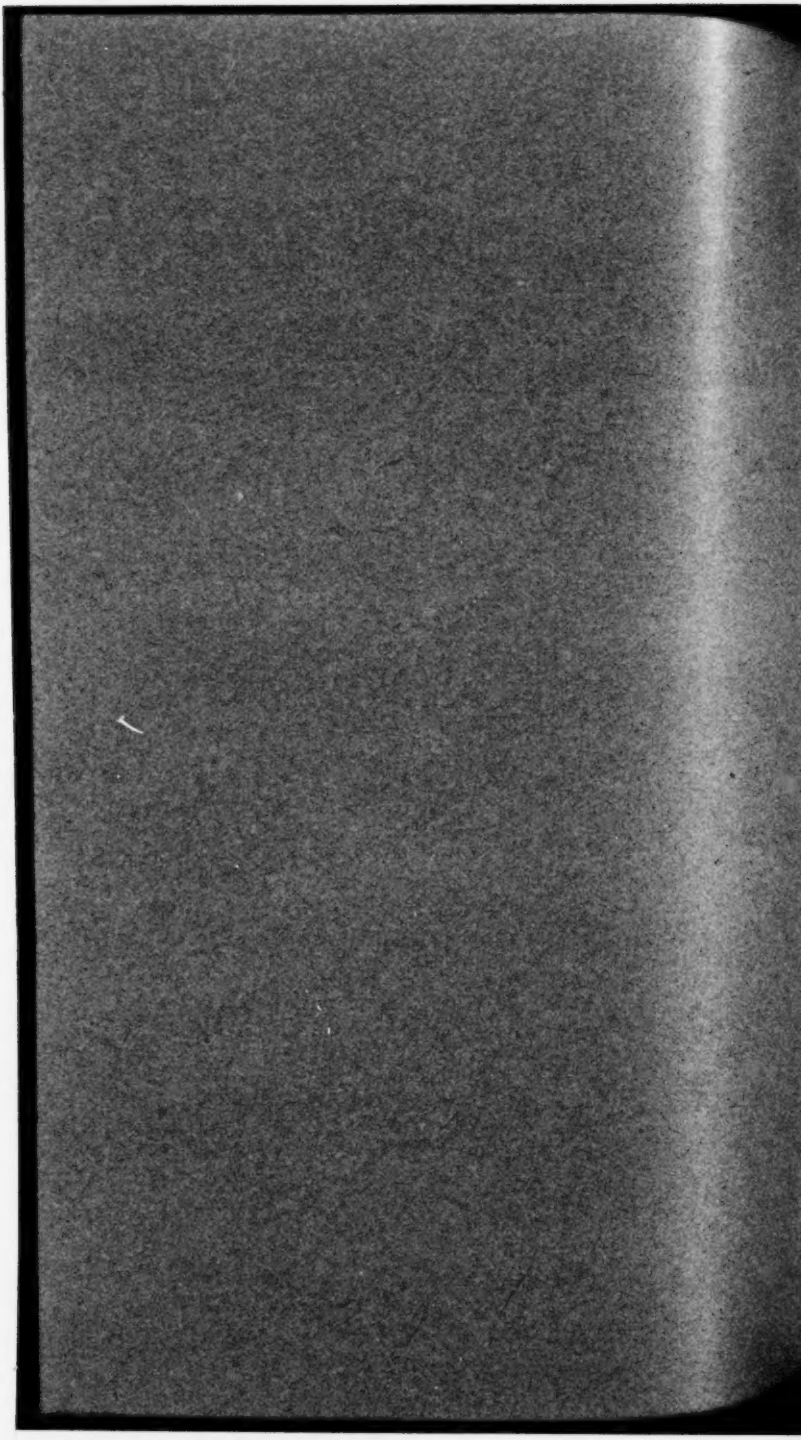
Defendant in Error.

In Error to the United State Circuit Court of Appeals for the Eighth Circuit.

BRIEF FOR DEFENDANT IN ERROR.

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Defendant in Error.

IN ERROR TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF FOR DEFENDANT IN ERROR.

STATEMENT OF THE CASE.

These were actions at law brought by T. B. Wallace, as Receiver of The Missouri National Bank of Kansas City, under direction of the Comptroller of the Currency, to enforce the stockholders' liability of Calvin Hood and Charles J. Lantry, who are the owners and holders of 100 and 200 shares respectively of the stock of said bank.

The issue tendered by the amended and substituted answers and cross-petitions in these cases are identical, and by agreement of counsel they have been briefed and argued together as if there were but one case.

After an original answer and cross-petition and many amendments, defendant, in each case, filed an amended and substituted answer and cross-petition on the 15th day of August, 1898, to which plaintiff filed a demurrer on the same date.

The first defense alleges that defendants were urged by the president of the Missouri National Bank to buy the stock of said bank, as it was the desire of said bank "to have them own stock of the said bank and their names connected with it, *as they were men of means and large business acquaintance in the State of Kansas, and that their connection with the said bank would be of benefit to it, because it would attract and secure a large amount of Kansas business otherwise unobtainable.*" [Record p. 6] and that they were induced by a number of false representations as to the condition of the bank to purchase, one, 100 shares and the other, 200 shares of its stock, for which they paid the full par value [Record pp. 8, 14, 15]; that certificates were issued to them, dated April 18, 1896 [Record pp. 9, 13, 15]; that they continued to hold said certificates of stock so issued and delivered to them until the 3d day of December, 1896, when the bank failed, and defendant in error was appointed Receiver [Record pp. 9, 10]; *that the Missouri National Bank received the money so paid by them for the purchase of said stock, and that the same was for the use and benefit of said bank* [Record p. 9]; that while they investigated the condition of said bank, and made full inquiries about its history, which investigation covered the period of several weeks [Record p. 6], and were furnished with a list of the securities and assets of said bank [Record p. 7], and secured the services of two expert bank examiners to examine the assets and condition of said bank [Record p. 8] before purchasing the stock, they were unable to discover the falsity of the representations made to them; that they made no such discovery durthe seven and a half months they continued to be stockholders prior to the failure of the bank; that from the time the certificates of stock were delivered to them "said bank was apparently doing a very large business, having a daily average of one million five hundred thousand ($1,500,000) deposits" [Record p. 8;] that after the failure they were deterred from making an examination by the fact that the books and papers were in the hands of the Receiver, who refused to let them inspect them [Record p. 9] until the 1st of September, 1897, when they received permission from the comptroller to inspect the books,

and thereupon " did make a careful and thorough examination into the actual condition and affairs of the bank," and " for the first time learned that the said representations made by the said D. V. Rieger, about the condition of said bank, were false, fraudulent and untrue " [Record p. 10]; that thereafter, on or about the 27th day of October, 1897, they tendered to the Receiver their certificates of stock, notifying him that owing to the fraud and deceit practiced upon them they disaffirmed the contract, and demanded that he cancel the certificates and repay to them the sums paid by them respectively, or such proportionate part thereof as they would be entitled to receive as creditors of the bank.

It will be noted, that they held this stock for nearly eight months before the failure of the bank and took no action to disaffirm the contract, until after the comptroller had made an assessment of one hundred dollars per share on their stock to pay the debts of the bank.

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The second defense incorporates, by reference, all the facts stated in the first defense, and alleges that prior to and during the negotiations with Lantry and Hood the officers of the bank "purchased or pretended to purchase from the stockholders or alleged stockholders of the said bank, with the funds of the bank, shares of the outstanding capital stock of the bank *in order to prevent exposure, by the stockholders owning such shares, of the actual condition of the bank;*" that such purchases were made in the names of officers or clerks of the bank, who received certificates therefor and gave their notes to the bank for money advanced by the bank to purchase the stock; that said purchases were not made for any reason or in any way authorized by law, and depleted the capital of the bank; that the president and other officers of the bank represented to them, when they were investigating the condition of the bank, "that all of the capital stock of said bank had been subscribed and issued to *bona fide* and actual purchasers in good faith, and was then held and owned by such parties as stockholders of said bank, *except an amount of said capital stock which said bank then had on hand, which had been taken in by the said bank to prevent a loss or indebtedness which had been previously contracted in good faith, and which had been taken in by the bank without violating the banking laws of the United States; that said defendant, believing said statements, did then and there purchase of the bank,*" etc., [Record pp. 13 14]; and, finally, "*that said parties who held said stock never at any time received the purchase money paid by this defendant for said stock, but the same was retained and kept by the bank.*" [Record p 15.]

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The cross-petition incorporates, by reference, all of the facts alleged in the first and second defenses; alleges that by reason thereof defendant has been damaged in the sum paid for the stock, and prays judgment against the Receiver for said sum, with interest from the 18th day of April, 1896, the date of the original purchase of said stock, and that the Receiver may be ordered to pay it ratably out of the assets and funds of said bank in his possession.

The plaintiff demurred, separately, to each of these defenses and to the cross-petition, on the grounds:

I. That this is an action at law to enforce the statutory liability of defendant as a stockholder in the Missouri National Bank for the benefit of creditors of said bank, and such defense, or counter claim, if it constitutes any defense, or counter claim at all, is an equitable defense, or counter claim, and can not lawfully be set up in this case.

II. That such defense is based upon alleged frauds, which were not committed by plaintiff, or the creditors for whose benefit this action is brought, but were, as alleged, committed by the Missouri National Bank, which is, therefore, a necessary party to the issues tendered by said defense, but is not a necessary or proper party to the original action, and that an off-set or counter claim against the bank itself can not properly be set up by the stockholder in an action brought by the Receiver to enforce the statutory liability of the stockholder.

III. That such defense, or cross-petition does not state facts sufficient to constitute a defense to plaintiff's cause or action stated in the petition, or to entitle defendant to any relief as against plaintiff. [Record pp. 16, 17.]

The cases were argued before Judges Phillips and Williams, and the demurrers were sustained September 28, 1898. [Record p. 18.] Judge Phillips handed down an able and elaborate opinion, which is reported in 89 Fed., p. 11.

Subsequently, November 28, 1898, Judge Riner gave judgment for the plaintiff in both cases for the full amount claimed, with interest from the time when defendants should have paid their assessments. [Record pp. 19, 20.]

The cases were then taken to the United States Circuit Court of Appeals on error, and that Court affirmed the judgments of the Court below. [Record pp. 27, 28, 31, 32.] The opinion of the Court is reported in 97 Fed., p. 865, and is printed in the Record in case No. 180 at pp. 26 to 31 inclusive.

The sustaining of the demurrers to the several defenses and cross-petition, and the rendering of judgment for plaintiff, are assigned as errors.

ARGUMENT.

We think a discussion of the questions in the order in which they are presented by the defenses, cross-petition and respective demurrers will facilitate an understanding of the case. We shall not attempt, therefore, to follow the order adopted in the brief of counsel for plaintiff in error.

The First Defense.

The first defense, by necessary implication, admits every allegation of the petition, the proper organization of the Missouri National Bank of Kansas City under the national bank act, its failure and the appointment of defendant in error as Receiver, December 3, 1896, the necessity for enforcing the individual liability of the stockholders and the assessment of $100 upon each and every share of its stock. It admits expressly that plaintiffs in error became purchasers, one, of 100, and the other, of 200 shares of said stock, April 18, 1896, and continued to hold them until after the failure of the bank seven and a half months later, and that they took no steps in all that time to rescind their purchase and to compel the bank to take back the stock.

It states that when they purchased the stock they were advised that it was the desire of the bank "to have them own stock of the bank and their names connected with it, *as they were men of means and large business acquaintance* in the State of Kansas, and that their connection with the said bank *would be of benefit to it, because it would attract and secure a large amount of Kansas business otherwise unobtainable.*" [Record p 6.]

It further states that from the time of the delivery of the certificates of stock to them, "said bank was apparently *doing a very large and prosperous business, having about a daily average of one million five hundred thousand* ($1,500,000) *deposits.*" [Record p. 8.]

They cannot, therefore, deny that many creditors of the bank became such *after* their connection with it as stockholders, or that old depositors continued business with the bank and made fresh deposits after such connection, or that they were influenced, to some extent at least, to become, or continue to be creditors of the bank, by the fact of their being stockholders.

The parties are presumed to have known, at the time of their purchase of stock, the provisions of Sec. 5151, holding the share-

holders of every national banking association "individually responsible, equally and ratably, * * * for all contracts, debts and engagements of said association, to the extent of the amount of their stock therein at the par value thereof, in addition to the amount invested in such shares."

When the bank failed they were still stockholders, and the action of the comptroller in assessing their stock was final and conclusive.

Kennedy v. Gibson, 8 Wall., 498.
Casey v. Galli, 64 U. S., 673.
United States v. Knox, 102 U. S., 422.
Bushnell v. Leland, 164 U. S., 684.

The first defense, if we understand it, amounts to this: that while they were legal owners and holders of the stock, and, as such, liable to pay their assessments, yet they ought not to be regarded as such owners and holders because they were induced to purchase it by the fraudulent misrepresentations of the president of the bank as to its condition and the value of the stock; its condition being in fact bad and the stock, practically worthless.

The demurrer to this defense rests upon three grounds.

I.

This is an action at law to enforce the statutory liability of the defendant as a stockholder in the Missouri National Bank for the benefit of the creditors of said bank, and said first defense, if it constitutes any defense at all, is an equitable defense, and cannot lawfully be set up in this case.

What is it defendant seeks to gain by this answer? Is it not to be put back in the position he would have occupied if he had never purchased or paid for his stock? He does not ask damages or to recover the money paid out for the stock—that comes later. What he wants and what he must have, if he relies upon this defense alone, is a rescission of the contract of purchase and a cancellation of the certificate and record showing that he is a stockholder. Can a court of law grant such relief? Manifestly not. A court of equity may, if the suit is brought in time, upon a proper showing and with the proper parties before it. But in the United States courts legal and equitable claims cannot be blended together in one suit, nor are equitable defenses permitted in actions at law.

In Northern Pacific R. R. Co. v. Paine, 119 U. S., 561,563. an action at law was originally brought in the State court, and both legal and equitable defenses were interposed.

Mr. Justice Field says:

"The case was then removed, on application of the defendant, from the State court to the Circuit Court of the United States. In that court the equitable defense could not be made available. In the courts of the United States, to legal actions legal defenses only can be interposed. If the defendant have equitable grounds for relief against the plaintiff he must seek to enforce them by a separate suit in equity."

In that case defendant admitted a sale of lands by himself to plaintiff and the legal title of plaintiff, but averred, in an action for damages for the conversion of certain timber thereon, that he had been induced to make the sale by fraudulent misrepresentations and had repudiated the sale and prayed: (1) that plaintiff take nothing by his action; (2) that the sale be adjudged void; and (3) plaintiff be decreed to reconvey, etc., on tender to him of the preferred stock taken in exchange for the same.

Mr. Justice Field says (p. 575):

"This defense was not, as already stated, available in the action at law after the removal of the case to the Circuit Court of the United States."

In Scott v. Armstrong, 146 U. S., 512, Chief Justice Fuller says:

"The jurisprudence of the United States has always recognized the distinction between law and equity as under the constitution matter of substance, as well as of form and procedure, and accordingly, legal and equitable claims cannot be blended together in one suit in the Circuit Court of the United States nor are equitable defenses permitted."

In Montejo v. Owen, 17 Blatch, 324, plaintiff brought an action at law on a judgment obtained by him in another State. The answer set up a number of defenses which were not defenses at common law, but which, it was claimed, gave defendant an equitable right to prevent the enforcement of the judgment. The Court says:

"This so-called defense is an affirmative equitable right to the relief asked * * * * The action is at common law. The defense is substantially an action in equity, and it can not,

because it assumes the guise of an answer or defense under the State law, escape from the control of the laws of the United States as to the modes of enforcing equitable rights. The demurrer must be sustained." [p. 327.]

In Sheafe v. Larimer, 79 Fed., 921, 923, Judge Shiras said:

"Although the defendant sets forth in the answer the facts relied upon as constituting false representations, *a rescission of the contract of sale is not prayed for, nor could it be properly sought in this action, the same being at law.*"

In Hill v. Northern Pacific Ry. Co., 104 Fed., 754, defendant set up as a defense to the action, which was one at law to recover damages, a written release by the plaintiffs on payment of an agreed sum in settlement of the cause of action, to which the plaintiffs replied that they were induced to make the settlement and to execute the release by false and fraudulent representations of the defendant's agents.

The Court held that the release could not be impeached in the action at law, and said:

"This defense to the action is an executed contract and proceedings to set it aside should be in equity, because the court, in relieving the plaintiffs from the obligation of their contract after it has been executed, must exert extraordinary power. 'Cancelling an executed contract is an exertion of the most extraordinary power of a court of equity.' Delaine Co. v. James, 94 U. S., 207-214" (p. 756).

See also Bennett v. Butterworth, 11 How., 669, 674, 775.
La Mothe Mfg. Co. v. Nat'l Tube Works, 15 Blatchf. 432, 435, 436.
Parsons v. Denis, 7 Fed., 317.
Doe v. Roe, 31 Fed., 97, 99, 100.
Buller v. Sidell, 43 Fed. 116, 117.

Citations of decisions of State Courts, where the distinctions between actions at law and suits in equity have been abolished and where defendants are allowed to set up as many defenses as they may have, whether they be such as have been heretofore denominated legal or equitable or both, are misleading and so are all text-book readings based upon such decisions.

We readily concede that if the allegations of the first defense showed that the stock purchased by Hood and Lantry was *overissued* or *unauthorized* stock, and therefore *void*, the defense would be good and a resort to equity unnecessary. Such was the case in:

Scevill v. Thayer, 105 U. S., 143.
Laredo Imp. Co. v. Stevenson, 66 Fed., 633.
Newton Nat. Bank v. Newbegin, 74 Fed., 135.
Winters v. Jackson, 37 Fed., 509.
New York, etc., R. R. Co. v. Schuyler, 34 N. Y. 30.

and a number of other cases cited by counsel for plaintiffs in error.

We also concede that, if a contract is illegal, prohibited by law, or otherwise *void*, no action can be maintained upon it. Such was the case in ;

Concord First Nat. Bank v. Hawkins, 174 U. S., 364, 371.
California Bank v. Kennedy, 167 U. S., 362.
McCormick v. Market Nat. Bank, 165 U. S., 550.
Central Transportation Co. v. Pullman Car Co., 139 U. S., 24,

and a number of other cases cited by counsel for plaintiffs in error.

But, as was [illegible] in Scovill v. Thayer, 105 U. S., 143: "A distinction must be ma[illegible] between shares which the company had no power to issue and shares which the company had power to issue, although not in the manner in which, or upon the terms upon which they have been issued. The holders of shares which the company has no power to issue, in truth *had nothing at all and are not contributors.*"

The first defense states clearly enough that the stock bought by Hood and Lantry was part of the original authorized stock of the bank, and therefore was not *itself invalid*. It was represented by the President to have been acquired by the bank in a lawful way, and was bought by Hood and Lantry, in good faith, relying upon that statement. [Record pp. 8, 12.] The stock therefore was good ; their title was valid ; and the only trouble was that they were deceived as to its *value*. This may have rendered the contract of purchase *voidable*, but not *void*.

Johnston v. Laflin, 103 U. S., 800, 802, 805.

The claim that the bank acquired the stock unlawfully, and that the transaction by which it was sold to Hood and Lantry was therefore void was raised in the second defense and will be treated in that connection.

Prior to the failure of the bank and the appointment of the receiver, there was no attempt on the part of the defendant to rescind his contract, and, as the bank can not now consent if it would, such rescission can only be effected in a court of equity on a proper showing. The assumption of defendant that he can rescind all by himself without

the consent of the other party to the contract, without regard to the rights of creditors, without proof of the facts which entitle him to such rescission and without the aid of a court of equity, is untenable. Completely executed contracts are not so easily set aside, and the legal liabilities of stockholders are not so easily thrown off. The fact that he does not, in either defense, pray for relief, does not alter the nature of his defense. A court of law cannot grant such relief, and can only proceed to enforce by judgment and execution the legal liability, it being once admitted that defendant was legally a stockholder.

II.

Said first defense is based upon alleged frauds, which were not committed by plaintiff or the creditors, for whose benefit this action is brought, but were, as alleged, committed by the Missouri National Bank, which is, therefore, a necessary party to the issues tendered by the defense, but is not a necessary or proper party to the original action.

The receiver, in these cases, is not pressing any claim of the *bank* against Hood and Lantry. He is pressing a claim which the bank itself could not enforce. Delano v. Butler, 118 U. S., 635, 653, 654. Neither he, nor the creditors whom he represents, committed the frauds of which the stockholders complain. They knew nothing of them. The party who, it is alleged, did perpetrate the fraud is not a party to the suit. It certainly is interested in the determination of this question, and we do not see how any rescission on the ground of fraud can be granted, or judicially recognized, in a suit to which it is not a party.

See Western Nat. Bank v. Armstrong, 152 U. S., 346, 354, 355.

III.

Said first defense does not state facts sufficient to constitute a defense to the plaintiff's cause of action stated in the petition, or to entile defendant to any relief as against plaintiff.

It is hardly worth while to combat the proposition of counsel for plaintiffs in error that the stockholder is under a *contract* obligation to pay the full amount of his stock, if necessary to satisfy creditors, upon the failure of the bank. It is certain that, if it be a contract it is not

one which the *bank* can enforce. The liability is one *imposed by statute* and not for the benefit of the bank, but for the benefit of creditors.

Sawyer v. Hoag, 17 Wall., 610, 620.
Upton v. Tribilcock, 91 U. S., 47.
Sawyer v. Upton, 91 U. S., 56, 60.
Richmond v. Irons, 121 U. S., 27, 55, 56.
Handley v. Stutz, 139 U. S., 417, 427.
Stuart v. Hayden, 169 U. S., 1, 8.
Matteson v. Dent, 176 U. S., 521, 526.
Sheafe v. Larimer, 79 Fed., 924.
Scott v. Latimer, 89 Fed., 843.
Wallace v. Hood, 89 Fed., 15.
Bailey v. Tillinghast, 99 Fed., 806.

It can be enforced only to the extent necessary to pay their claims. The receiver represents creditors only in bringing these suits and no defense, however valid as against a claim of the bank, can be of any avail as against creditors of the bank, unless it can be shown that the stock was *void*, or that the contract of subscription or purchase was rescinded *before* the rights of creditors intervened.

If the plaintiffs in error had been able to allege that no creditors of the bank became such, or continued to carry on business with the bank and make deposits, *after* they purchased the stock, we might concede the right to rescission, because rescission, under such circumstances, would not injuriously affect the rights of any who were not in privity with the bank ; but the allegations of this defense as to the large volume of business carried on by the bank and the large average daily deposits after they became stockholders, leave no room for doubt that the equities of hundreds of creditors have intervened and would be prejudiced by rescission.

For more than forty years the courts of England and this country have had to deal with efforts of stockholders to evade their statutory liability on stock subscribed or purchased by them, after the failure of corporations, on the ground that they had been induced, by fraudulent misrepresentations on the part of company officers or agents, to subscribe for or purchase the stock.

During that period the courts, while differing somewhat in their reasoning, have uniformly held that while such fraudulent conduct on the part of the company's agents might justify a rescission if the party defrauded acted promptly and before the rights of third parties intervened, it was too late to rescind after the failure of the company,

owing more than its assets would pay, making it necessary, in order to pay creditors, to enforce the stockholders' liability ; and it was said in nearly all of them that it was immaterial that the stockholder did not find out that he had been defrauded until after the failure. The equities of creditors were then superior to his equity.

The leading cases are as followe :

ENGLAND.

1857. Henderson v. Royal British Bank, 7 El. & Bl., 356, 363, 364.

1858. Clarke v. Dickson, El. Bl. & El., 148, 154.

1867. Oakes v. Turquand, L. R., 2 H. L., 325, 345, 350.

1872. Pugh & Sharman's Case, L. R., 13 Eq., 566, 572.

1877. Stone v. City and County Bank, L. R., 3 C. P. Div., 293, 294, 295, 299, 307, *et seq.*

1879. Tennent v. Glasgow Bank, 4 App. Cas., H. L. (Sc), 615.

1880. Burgess' Case, 15 Ch. Div., 509, 511, 512.

1880. Houldsworth v. City of Glasgow Bank, 5 App. Cas., 317, 322.

1883. Re Scottish Petroleum Co.; Wallace's Case, 49 L. T., (N. S.) 348, 355

1890. Lennox Publishing Co., In re, 62 L. T., (N. S.) 791.

1898. Central Klondyke Gold, &c. Co., In re Thomson's Case, 5 Manson, 282, 336.

1899. General Railway Syndicate, In re Whiteley's Case, 80 L. T., (N. S.) 868 ; 6 Manson, 244.

U. S. SUPREME COURT.

1859. Ogilvie v. Knox Ins. Co., 22 How., 380, 389, 390.

1875. Upton v. Tribilcock, 91 U. S., 45, 50, 54, 55.

1877. Chubb v. Upton, 95 U. S., 667.

1877. Pullman v. Upton, 96 U. S., 328, 330, 331.

1891. Finn v. Brown, 142 U. S., 56, 71.

1896. Pauly v. State Loan & Trust Co., 165 U. S., 606, 622.

U. S. CIRCUIT COURTS AND COURTS OF APPEAL.

1874. Upton v. Englehart, 3 Dill., 496, 503, 504.

1875. Farrar v. Walker, 3 Dill., 506, 510.

1896. Latimer v. Bard, 76 Fed., 536, 540, 541.

1897. Sheafe v. Larimer, 79 Fed., 921, 923.

1897. Tillinghast v. Bailey, 86 Fed., 46, 48.
1898. Wallace v. Bacon, 86 Fed., 553, 556.
1898. Scott v. Latimer, 89 Fed., 843.
1898. Wallace v. Hood, 89 Fed., 11, 15, 16, 23.
1899. Lantry v. Wallace, 97 Fed., 865, 867, 868.
1900. Bailey v. Tillinghast, 99 Fed., 801, 808.

NEW YORK.

1858. Empire City Bank, 6 Abb. Pr., 385, 402.
1860. In re Reciprocity Bank, 22 N. Y., 9, 17.
1875. Ruggles, Receiver, v. Brock, 6 Hun., 164.
1879. Hurd v. Kelley, 78 N. Y., 588, 597.
1881. Briggs v. Cornwell, 9 Daly, 436, 438, 439.

OTHER RECENT CASES.

1880. Turner v. Granger Life Ins. Co., 65 Ga., 649, 651, 652.
1881. Jewell v. Rock River Paper Co., 101 Ill., 57, 67, 68.
1887. Duffield v. Barnum Iron & Wire Works, 64 Mich., 293, 300.
1890. Howard v. Glenn, 85 Ga., 260 to 262.
1893. Howard v. Turner, 155 Pa. St., 349, 357, 358.
1894. Bissell v. Heath, 98 Mich., 472, 475, 476.
1894. Dunn v. State Bank, 59 Minn., 221, 228, 229.
1897. Olson v. State Bank, 67 Minn., 267, 274 to 279.
1897. Harrington v. Connor, 51 Neb., 214, 219.

An examination of these cases will disclose that every argument and suggestion made by counsel for plaintiffs in error in this case has been urged, considered and decided in some one or more of them.

We quote from the opinions in some of them by way of illustration.

In Henderson v. Royal British Bank, 7 El. & Bl., p. 364. the Court says:

"This is an application by a creditor who, upon the faith of the party, who was then a shareholder and who held himself out to the world as a shareholder and being one, gave credit to the bank. * * *

"It would be monstrous to say that he, having become a partner and a shareholder and having held himself out to the world as such, * * * could thus get rid of his liability to the creditors of the bank who had given credit to it on the faith that he was a shareholder.

* * * "Suppose this was a common partnership and that there

was credit given to the firm, would it be any answer to an action by the creditor against one of the partners that the defendant was fraudulently induced by the other partners to become a partner?"

In Clarke v. Dickson, El. Bl. & El., 148, 154, Erle, J. says:

"Lastly the offer to restore these shares is not made till after the company is in the course of being wound up, when all chance of profit is over and the shares can only be a source of loss. I have looked at this as if no others were concerned but the plaintiff and the defendants; but no doubt *there may have been liabilities incurred by the plaintiff to third persons rendering it impossible for him to rescind.*"

In Oakes v. Turquand, L. R. 2 H. L., 345, 346, the Court says:

"On the part of the shareholders it is contended that a person who has been induced by fraud to enter into a contract to take shares, and whose name is afterwards placed upon the register, never becomes a shareholder because his agreement, being obtained by fraud, is of no validity." * * *

"It is a settled rule of law, as Mr. Justice Crompton says in Clarke v. Dickson, E. B. & E., 148, 'that a contract induced by fraud is not void but voidable only at the option of the party defrauded. If it were otherwiee—if a contract induced by fraud were void—there would be an end of the question in this case because a contract void in itself can have no valid beginning, and Oakes never would have become a shareholder of the company.'" (348.)

The Court then expressly affirms Henderson v. Royal British Bank, 7 E. & B. 355, (p. 348), and says, (p. 350):

"But, when the order for winding up came and found him with the shares in his possession and his name upon the register the agreement was a subsisting one. How could it then be said that he was not a person who had agreed to become a member? To hold otherwise would be to disregard the long and well established distinction between void and voidable contracts." * * * * *

"The liability of the shareholders is not under a contract with the creditors, but it is a statutory liability, under which the creditors have a right which attaches upon the shareholders to compel them to contribute to the extent of their shares towards the payment of the debts of the company. * * * * * * * * *

* * * The application of the creditor was resisted by the shareholder on the ground that he had been induced by fraud to take the shares. It is a fair answer by a creditor to such a defense to say I know nothing of the circumstances which led you to become a shareholder; all I know is that you, in fact, allowed yourself to be represented as being a shareholder and on the faith of your being so, I trusted the company. (pp. 361, 362) * * * * *

"The argument is that he did not so agree, because all which he did, he did under the influence of fraud and misrepresentation. But

assuming all that to be, and I believe it was just as Mr. Oakes represents it, still he did agree to become a member—that is, he in fact, agreed. He may have full rights against those who deceived him, but with that the outer world can have no concern. The Legislature took care to provide the register as the means of enabling persons dealing with the company to know to whom and to what they had to trust. It intended to put the persons whose names are on it in the same position towards creditors * * * as persons engaged in an ordinary partnership or persons trading formerly under the acts of 1844. In neither of these cases would it have been any answer to a creditor, that the person sought to be charged had been induced by fraud to become a partner or a shareholder, and I see no reason whatever for adopting any other principle here." (367.)

"It is impossible to allow a person who has taken shares and has gone for nearly a year taking his chances of profit, to turn round when the speculation has proved a failure and claim to be released on the ground that he was ignorant of something with which the least diligence must have made him acquainted." (369.)

In Stone v. City and County Bank, L. R., 3 C. P. Div., 293–4–5, the Court says:

"Before the plaintiffs repudiated their shares and before, in fact, they discovered the fraud entitling them to repudiate their shares, a resolution was passed for winding up the company voluntarily. * * * And it is admitted * * * the assets of the company, including its uncalled capital, were not sufficient to pay its undisputed debts and liabilities. * * * * * * *

"I am of opinion that this winding up and state of assets are fatal to the plaintiffs and afford a complete defense to both actions. * * * * * * * * * * *

"Their claims are based on the theory that they are no longer shareholders—on the theory, namely, that notwithstanding the winding up and the state of the assets to which I have alluded, they had a right to rescind them and *had rescinded* their contracts before the commencement of their action. *But if the plaintiffs had no right to rescind their contracts their actions were not sustainable.*"

"Now it appears to me that Oakes v. Turquand, L. R. 2, H. L., 325, shows conclusively that the plaintiffs had no such right. It was contended by the plaintiffs that, for several reasons, this decision did not apply to the present cases. First, it was said that it does not appear that any of the debts of the company were contracted on the faith of the plaintiffs being members of it, and that the decision in Oakes v. Turquand was based on what Lord Campbell said on the subject of estoppel in Henderson v. Royal British Bank (7 R. & B., 356).

"But in the first place it did not appear in that case that Henderson trusted the Royal British Bank by reason of Goddard being a shareholder in it, nor was there evidence in Oakes v. Turquand that any creditors in particular had trusted Overend, Gurney & Co., Ltd.,

by reason of Oakes being a shareholder therein. The observations in both cases on the subject of estoppel are of a general nature, and, as I understand them, are *applicable to all registered companies whose registers of shareholders are open to inspection without reference to the question whether any particular member has more or less induced credit to be given by any particular creditor.* * * * * * *

"I doubt whether a shareholder is liable upon the ground of estoppel. I think his liability depends upon a principal similar to that upon which the decision in Kingsford v. Merry (11 Ex., 577) proceeded. It was there held that *if the owner of goods sells them, owing to a fraudulent representation, and if, before he discovers the fraud, another person acquires some claim to them, he cannot afterwards rescind the contract, and I think it clear upon the authorities that whenever the rights of other persons intervene a contract to take shares, though induced by fraud, cannot be rescinded.*" (pp. 308, 309.)

In Re Scottish Petroleum Co.; Wallace's Case, 49 L. T. (N. S.) 348, 355, Fry, L. J., said:

"Now the general principal is that no contracts can be rescinded so as to effect rights acquired *bona fide* by third parties under it. It is true the creditors and the other shareholders have not acquired direct interests under the contracts; but they have acquired an indirect interest. The shareholders have got a co-contributory; the creditors have got another person liable to contribute to the assets of the concern. * * * There must, in the case of a voidable contract to take shares, be repudiation and something more before the winding up commences."

Sec. 5210 of the National Bank Act requires that:

"The president and cashier of every national banking association shall cause to be kept at all times a full and correct list of the names and residences of all the shareholders in the association and the number of shares held by each, in the office where its business is transacted. *Such list shall be subject to the inspection of all the shareholders and creditors of the association.*"

In Pauly v. State Loan & Trust Co., 165 U. S., 612, 621, 622, the Court says:

"Manifestly one, if not the principal object of this requirement, was to give creditors of this association, as well as State authorities, information as to the shareholders upon whom, if the association becomes insolvent, will rest the individual liability for its contracts, debts and engagements.' (Pullman v. Upton, 96 U. S., 328, 330, 331; National Bank v. Case, 99 U. S., 628, 631.) * * *

"It is true that one who *does not in fact invest his money in such shares, but who,* although receiving them simply as collateral security for debts or obligations, *holds himself out in the books of the association*

as the true owner, may be treated as the owner and therefore liable to assessments when the association becomes insolvent and goes into the hands of a receiver. But this is upon the ground that by allowing his name to appear upon the stock list as owner he represents that he is such owner; and he *will not be permitted, after the bank fails and when an assessment is made, to assume any other position as against creditors.* If, as between creditors and the person assessed, the latter is not held bound by that representation, the list of stockholders required to be kept for the inspection of creditors and others would lose most of its value."

The arguments based upon the public registry of stockholders in England, therefore, apply with equal force to the stockholders of national banks.

In Upton v. Englehart, 3 Dill., 496, 503, Judge Dillon says:

"But the proposition is not a sound one that the right of a person, who has been drawn into the purchase of stock by the fraud of a company or its agents, to relief, is as great against creditors as it would be against the company. * * * If their corporate representatives or its agents have practiced a fraud upon him he is entitled to relief against it. But if a person has accepted a certificate of stock and becomes *to all external appearances a stockholder, persons may have become creditors of the company on the faith of his membership and in law are presumed to do so*, and as they cannot know the manner in which he was induced to become a stockholder there is ground to maintain that as to them the manner is immaterial."

In Pullman v. Upton, 96 U. S., 328, 330, Justice Strong says, citing with approval Adderly v. Storm, 6 Hill, 624:

"The retransfer was not made, however, until March 2, 1840, and the defendants were held liable as stockholders for a debt of the company contracted in January, 1840, and *this it was said, would be the law, though the plaintiff may not have known at the time he trusted the company, that the defendants could be reached.*"

In Stufflebeam v. De Lashmutt, 83 Fed., 449, the Court says:

"If in this case any creditor, for the payment of whose debt the assessment sued on was levied, had become a creditor after the transfer to De Lashmutt of the shares of stock upon which he is sought to be held the principles of the case of Pauly v. Trust Co. (165 U. S., 605) would apply. In such case it must be said that the creditor acted upon representation that De Lashmutt was a stockholder in extending his credit to the corporation; and in that case, whatever equities there might be as between De Lashmutt and the persons from whom he took the stock these would not avail the defendant as against the innocent creditor who dealt with the corporation without knowledge of these equities."

"In this case, De Lashmutt bought his stock only twenty days before the failure of the bank, and "it was *not claimed that any debt of the corporation was created between the time of the transfer and the levying of the assessment, so that, so far as the creditors of the bank are concerned, they had not been affected by the transfer.*"

In Latimer v. Bard, 76 Fed., 536 to 541 after citing Upton v. Tribilcock, and Sanger v. Upton, the Court says:

"These defendants allowed themselves to be held out as shareholders of the bank and under the laws as liable to creditors to the extent of the amount of stock held by them. * * * Relying upon this security, depositors trusted the bank and it became indebted to divers persons in such large amounts that at least seventy-five per cent. of the capital stock (besides all the other assets of the bank,) is required to pay them, (540).

By their conduct they influenced persons to their injury. They ought, therefore, unless some controlling principle of law is violated, to be held to the liabilities to which they have apparently been subject. But it is said they are not bound because they did not know the facts relied upon now as a defense until the failure of the bank and after the assessment was made by the comptroller against them and because they could not by reason of the fraudulent conduct of the affairs of the bank, by the exercise of ordinary care have ascertained such facts sooner. I do not think they can be heard to excuse themselves in this way. They ought to have been more diligent in ascertaining and knowing the facts. * * * * * * * * *

They admit that they did, in fact, discover the truth after they were called upon to respond to their apparent liability.

This admission shows that the discovery was not only possible, but that when their financial interests required attention they were able to discover the facts of the case."

This is especially applicable in view of the facility with which Hood and Lantry discovered the alleged frauds by an inspection of the books and papers of the bank, after they received permission from the comptroller. All that the books and papers disclosed then, they would have disclosed earlier, if properly examined. Their answer shows [Record p. 14] that, even before their purchase of stock, there were other stockholders threatening to *expose the actual condition of the bank.* Was the diligence of these shareholders superhuman, or were Hood and Lantry and their two expert bank examiners simply negligent?

In Tillinghast v. Bailey, 86 Fed., 46, Clark, J., says:

"Nor is it any answer to say that if the plaintiff in the case does not show that any particular creditor relied on the increased stock and the

payments made thereon by the defendants and was deceived thereby. The public in dealing with these banking associations do not rely except upon public, known facts in regard to the associations, and the public are not supposed to be familiar with or rely on the facts of a particular case as between the shareholders and the bank. A rule which exacted any such condition as this would practically deprive innocent creditors of any remedy." (p. 48.)

In Hurd v. Kelley, 78 N. Y., 588, 597, the Court says:

"It would be gross injustice to permit the defendant after having *aided the bank to procure credit with the community to avoid as against depositors and creditors the payment of his bond* on the allegation that the exact condition of the bank was not disclosed to him, or that it was much worse than represented.

"The dealings between (defendant) and the officials of the bank at whose request he signed the bond, ought not in justice to be allowed to offset the security given by him for the protection of those dealing with the bank, and *who must be presumed to have relied thereon in their dealings.*"

For nearly eight months the defendants were publicly held out as stockholders of the bank, and all the world invited to extend credit to it on the faith of their being such. The very object of getting them in as shareholders, as the defendants admit, was to strengthen the credit of the bank and get new depositors. Under the circumstances they are estopped from denying, as against new creditors and old creditors continuing business with the bank and suffering loss thereby, that *they are stockholders.* In equity the rights of such creditors are superior to their rights as defrauded shareholders, and they cannot escape their legal liability. This is made clear by the authorities cited.

Most of the cases cited by counsel for plaintiff in error on this point are readily distinguished from the case at bar. They may, however, be more appropriately considered in connection with the demurrer to the cross petition.

Whatever comfort plaintiffs in error might otherwise have derived from the dissenting opinion in Duffield v. Barnum Iron & Wire Works, 65 Mich., 293, is denied them by the later decision, by a unanimous court, in Bissell v. Heath, 98 Mich., 472, 474, 476. In that case the Michigan court recognizes fully the principle that the equities of creditors are superior to those of stockholders who seek to rescind their stock subscription, on the ground of fraud, after the company has failed.

We have not regarded the statement,

"That no part of the original capital stock of said bank was ever actually paid for as required by the banking laws of the United States, nor was any part of the reduced capital stock of two hundred and fifty thousand dollars ($250,000) ever paid for. That said capital stock had, in many instances, been issued to irresponsible parties and worthless notes taken therefor." (Record pp. 11 and 12.)

as intended to set up an independent defense to the action, but have treated it as only one of the many instances of the deception which was practiced on Hood and Lantry, and in this we are justified by the statement of counsel for plaintiffs in error. (See their brief, p. —.)

Judge Phillips effectually disposes of any claim that such irregularities in the organization would constitute a defense to this action, in his opinion (89 Fed., pp. 18 to 22), and so does the Circuit Court of Appeals for the Eighth Circuit, in Scott v. Latimer, 89 Fed., 845 to 851.

The Second Defense.

The defense incorporates by reference all of the allegations of the first and adds a statement to the effect that the bank purchased its own stock from dissatisfied stockholders with the funds of the bank in violation of the law (Revised Statutes § 5201) and that this stock so purchased was the stock afterwards sold and transferred to Hood and Lantry. Of course, the adjectives "pretended," "alleged" and "attempted" are used, to save the question as to whether there was any valid transfer, and counsel for plaintiffs in error contend that the purchase by the bank was *ultra vires* and therefore *void*, that it therefore had no stock to transfer and that defendants acquired none and therefore are not and never were stockholders in the bank.

This raises the only question not already discussed.

The cases they cite go to show that where a bank purchases stock which it had no right to buy, it may disaffirm the contract and refuse to pay calls and assessments upon it and its receiver may also disaffirm the contract and sue to recover the money paid out on such *ultra vires* purchase, but these were cases where the bank still retained the stock in its possession. They cite no case in which the bank has parted with the stock so acquired to a *bona fide* purchaser, and we challenge them to produce a case in which it is held that the subsequent purchaser of such stock acquires no title.

We find, on the contrary, that the exact question was raised and

decided adversely to their claim In re Reciprocity Bank 22 N. Y., 9, 16, 17. In that case Chief Justice Comstock says.

"The objection to the apportionment of liability urged by this class of appellants is, that *the bank could not, in the manner stated, legally become the purchaser or owner of its own stock, and therefore that these persons could not and did not acquire a derivative title from the bank.* In support of this objection the statutes have been referred to, which impose restraints upon the specially chartered banks in this State, in respect to dealing in their own stock (1 R. S., 589). We think it unnecessary to inquire whether the purchase by this bank of shares of stock under the circumstances above mentioned, falls within these restraints. Assuming that the bank owned the stock, the directors caused it, or a portion of it to be sold to Alexander and others. They became actually the purchasers, and they voluntarily suffered their names to appear as stockholders on the books. They cannot in this proceeding" (a suit to enforce stockholders' liability), "impeach their own title. * * * if a party makes an actual purchase of shares, whether from the bank or an individual holder, and voluntarily allows himself in this manner to be represented to the world as a stockholder, he must take the responsibilities of the situation. He comes within the terms of the policy of the act. Equities may exist between him and other parties; the shares may be in dispute; they may be claimed by some one else in hostility to his own right. The statute has no regard to such questions. The person who has caused or allowed his title to be registered on the books cannot deny the truth of that representation and disavow the ownership when it ceases to be a benefit and comes to be a burden."

In Belknap v. Adams, 49 La. Ann., 1350, defendants had received as a donation from the company their proportion of certain shares of its own stock purchased by the company, from another stockholder. The Court says:

"It is urged on us by the defendants that the one hundred and fifty shares had been paid for by the subscribers to whom it had issued before the increase: that the stock was purchased by the company and hence defendants, the sole corporators, had the right to divide it without any resulting liability to creditors. * * * *

"We have in this case the division of purchased stock, which by the purchase, was canceled and remained canceled for all purposes, until reissued. This is the well-defined result when the corporation purchased its stock. The purchase is an unauthorized use of corporate funds. * * * * In our view the defendants incurred the liability of shareholders when they took the fifteen thousand dollars of the stock purchased and afterwards reissued to them by the corporation, and that liability subsists in favor of the creditors." [1352, 1353.]

In National Pemberton Bank v. Porter, 125 Mass., 333, an

effort was made to defeat the action of the bank on a promissory note which it purchased from an indorsee contrary to the statute; the Court said, (p. 334):

"What is the contract which is said to be *ultra vires?* Not the contract in suit, but another contract, to-wit, the contract with Benyon, who is not in any sense a party to the contract in suit, nor is it necessary to the maintenance of this action to connect him with it. The contract with Benyon, assuming such a contract to have been made, and, for the purposes of this discussion, assuming it to have been *ultra vires*, is not executory; this suit is not to enforce it, but it has been fully and completely executed. It is true that the contract with Benyon was one of which the contract in suit was the subject matter. The question then arises, can a party to a contract in itself lawful and into which all the parties to it had authority to enter, be made null or be incapable of enforcement, because the plaintiff has entered into and fully performed, with another and totally distinct party, a contract in reference to it which was unauthorized, even though by such contract he becomes a party to the contract in suit?"

And the court answered this question in the negative.

In Holmes, etc., Co. v. Holmes & Wessel Metal Co., 53 Hun., 52, 57; S. C., 127, N. Y., 252, 260, plaintiff sued on a note given for stock of the defendant company, which it had four years before received in payment for its business and plant, and the plea was interposed that the plaintiff had no power to take the stock. The court said (p. 260): "To hold that the plaintiff could not dispose of the stock would deprive it of the consideration received for the transfer of its rolling mill and material, thus accomplishing a wrong and not advancing justice."

The stock in this case belonged to the original issue and was valid. The case, therefore, differs radically from the cases cited, in which corporations issued stock in excess of the limits of their charter. Purchasers of such over-issued stock have almost invariably been denied the rights of stockholders, and the transactions are void because the subject matter of the transactions is a nullity. Not so, however, with valid stock. The object of the statutes prohibiting banks from purchasing and holding their own stock is to prevent the extinction of stock once regularly issued, and the withdrawal of that much capital.

Bank v. Lanier, 11 Wall., 374, 375.
Bank v. Stewart, 107, U. S., 676.

While the bank holds the stock such reduction of capital would be effected, unless it or the receiver were allowed to pursue the person from whom it purchased the stock, as in Burrows v. Niblack, 84 Fed., 181. But when the bank has resold the stock to a *bona fide* purchaser and has received the money for it, as in the case at bar, the capital is restored and the object of the statute is fully satisfied. In such case no one but the government has a right to complain. The title of the purchaser is valid as against all the world. The original holder has received his consideration for it and can not reclaim it. The creditors of the bank are not defrauded because the capital has been restored. The purchasers can not complain because they have received valid stock for which they bargained.

In National Bank of Xenia v. Stewart, 107 U. S., 676, Justice Field said, in passing upon the very section of the national bank act, on which plaintiffs in error rely:

"While this section, Section 5201 R. S., in terms prohibits a banking association from making a loan upon the security of shares of its own stock, it imposes no penalty, either upon the bank or borrower, if a loan upon such security be made. If, therefore, the prohibition can be urged againt the validity of the transaction by any one except the government, *it can only be done before the contract is executed, while the security is still subsisting in the hands of the bank. It can then, if at all, be invoked to restrain or defeat the enforcement of the security. When the contract has been executed, the security sold, and the proceeds applied to the payment of the debt, the courts will not interfere in the matter.* * * Supposing it was unlawful for the bank to take those shares as security for a loan, it was not unlawful to authorize the bank to sell them when the contingency occurred. The shares being sold pursuant to the authority the proceeds would be in the bank as his property."

To paraphase Justice Field's dictum:

Supposing it was unlawful for the bank to purchase these shares, it was not unlawful for the bank to sell them. The statute expressly provides that stock acquired by a bank shall be "sold or disposed of at public or private sale." The shares being sold, the proceeds would be in the bank, its capital restored and the rights of creditors unaffected.

As was said by Justice Swayne in National Bank v. Matthews, 98 U. S., 626:

"The intent, not the letter, of the statute constitutes the law.

A court of equity is always reluctant in the last degree to make a decree which will effect a forfeiture."

And again:

"Where a corporation is incompetent by its charter to take a title to real estate, a conveyance to it is not void, but only voidable, and the sovereign alone can object. It is valid until assailed in a direct proceeding instituted for that purpose." * * * *

"So an alien, forbidden by the local law to acquire real estate, may take and hold title until office found." (p. 628.)

And again:

"We cannot believe it was meant that stockholders and perhaps depositors and other creditors should be punished and the borrower rewarded, by giving success to this defense whenever the offensive fact shall occur. The impending danger of a judgment of ouster and dissolution was, we think, the check, and none other contemplated by Congress." (p. 629.)

And the court held that the bank was entitled to enforce a trust deed taken, in violation of the statute, to secure a contemporary loan. This was expressly affirmed in National Bank v. Whitney, 103 U. S., 101, 102.

In Reynolds v. Crawfordsville Bank, 112 U. S., 405, 413, an action by the bank to quiet title to real estate purchased by it, some of which had been mortgaged to it to secure a debt and some not, it was objected that it was contrary to law for the bank to make such purchase.

The Court says:

"But if there was any force in this objection to the title it could not be raised by the debtor, for where a corporation is incompetent by its charter to take a title to real estate a conveyance to it is not void but only voidable; the sovereign alone can object. It is valid until assailed in a direct proceeding instituted for that purpose."

See also Fortier v. New Orleans Bank, 112 U. S., 439, and Thompson v. St. Nicholas Nat. Bank, 146 U. S., 240, 251, in which National Bank v. Matthews, and National Bank v. Whitney are expressly affirmed, and Smith v. Sheeley, 12 Wall., 358, 361.

Mr. Justice Hunt, passing upon another statutory prohibition in Gold Mining Co. v. National Bank, 96 U. S., 642, said:

"We do not think that public policy requires, or that Congress intended, that an excess of loans beyond the proportion specified

should enable the borrower to avoid the payment of the money actually received by him. This would be to injure the interests of creditors, stockholders and all who have an interest in the safety and prosperity of the bank."

Nothing is urged, for or against, the bank in this suit. It is not asked to affirm or disaffirm the contract of purchase. The interests of creditors alone are involved, and surely a court of equity will not allow the purchasers and present holders of stock to annul their own purchase and defeat the rights of creditors because the bank did something which it ought not to have done.

The case is analogous to those in which deeds from corporations or aliens prohibited by law from purchasing and holding real estate, or from holding beyond a certain time, have been held to give a good title to *bona fide* purchasers, defeasible only by the State if at all.

See Banks v. Poitiaux, 3 Rand. (Va.). 136, 142.
Rutland, etc., Ry. Co. v. Proctor, 29 Vt., 93, 97.
Leazure v. Hillegas, 7 S. & R., 313, 322.
Runyan v. Lessee of Carter, 14 Pet., 122, 131.
Hickory Farm Oil Co. v. Buffalo, etc., Ry. Co., 32 Fed., 22.
Telegraph Co. v. Telegraph Co., 22 Cal., 398, 431.
Water Co. v. Clarkin, 14 Cal., 544, 553.
Tarpey v. Deseret Salt Co., 5 Utah, 494, 502.
Silver Lake Bank v. North, 4 Johns. Ch., 370, 373.
Land v, Coffman, 50 Mo., 243, 254.

Our conclusion is that if the law prohibits the purchase and holding of its own stock by a bank, its policy will also require the earliest possible disposition of the stock and restoration of capital, and its spirit is carried out when, as in this case, a sale is made to a *bona fide* purchaser and the bank receives the par value of the stock.

The bank may be punished for purchasing its own stock by forfeiture of franchise and being put in the hands of a receiver, but its creditors will not be punished by allowing subsequent holders of this same stock to escape their statutory liability.

The demurrer to the second defense should be sustained.

The Cross-Petition.

The cross-petition incorporates, by reference, all of the allegations of the first and second defenses, and adds that "by reason of the facts stated, and the fraud and deceit practiced upon him by the said Missouri National Bank of Kansas City, Missouri, and its officers, he, the

said defendant, has been injured to his damage in the sum of twenty thousand dollars ($20,000), with interest thereon from the 18th day of April, 1896; that he has presented such claim to the plaintiff herein as such receiver, for allowance as a claim against said bank, and that the same has been rejected and refused by the plaintiff as such receiver," and prays for judgment against the said Wallace as receiver for the said sum of $20,000, with interest from the 18th day of April, 1896, the day he purchased said stock.

The demurrer to this cross-petition is based upon four grounds.

If this "cross-petition" be considered as a proceeding for rescission of contract, cancellation of stock certificate and recovery of money paid out under the contract on the ground of fraud, it is essentially an equitable proceeding, and the discussion of the first and third demurrers to the first defense is applicable to it. We need not repeat it here.

If, on the other hand, as appears from the prayer, it is an action at law for damages for the deceit practiced upon plaintiff in error by the bank, the second and fourth grounds for the demurrer are well taken.

II.

Said "cross-petition" is based upon alleged frauds which were not committed by plaintiff or the creditors whom he represents in bringing this action, but were, as alleged, committed by the Missouri National Bank, which is not a party to this action, and an off-set or counterclaim against the bank itself cannot properly be set up by the stockholder in an action brought by the receiver to enforce the statutory liability of the stockholder.

IV.

Said "cross-petition" does not state facts sufficient to constitute a counter claim in favor of defendant and against plaintiff, or to entitle defendant to any relief as against plaintiff.

Plaintiffs in error have no claim against the creditors or the receiver. They have asserted a claim which, if established, is good only against the bank. The *bank* is not asserting any claim against them in these suits, nor is the receiver asserting any claim *which the bank had* against them. It is as though A. has sued B. and B. had answered, I admit your claim to be good, but I have a claim against C. for getting me into the position which made your claim good. Such a claim cannot be asserted by a defendant, even under the Kansas code. The argument that this claim for damages for deceit practiced by the bank comes under §95 of the Kansas code strikes us as far-fetched and fanciful in the extreme. The receiver claims that Hood and Lantry were shareholders at the time the bank failed; that their statutory liability then attached; and that they must pay the assessment upon their stock made by the comptroller for the benefit of creditors. They answer, we were cheated by the bank when we bought this stock, eight months before the bank failed and this liability attached. Plaintiff did not cheat us; the creditors did not cheat us; we had no contract, or transaction with them; they had no existence, as such, at the time we bought the stock; their claim is founded on a statute to which the comptroller alone can give effect; but the bank cheated us and we want to set up a little claim of our own against the bank.

How can it be said that such a claim is one "existing in favor of a defendant and against a plaintiff between whom a several judgment might be had in the action and arising out of the contract set forth in the petition?"

As has been declared over and over again, *the receiver does not represent the bank* in bringing this action. The bank is not represented in the case, any more than T. B. Wallace, individually, is represented. The capacity in which he sues is distinct and must be kept in mind. He represents *creditors* and *creditors only*—in this action. What had *they* to do with the original contract of purchase? What judgment can be had against *them?* What connection is there between the fraud of the bank, which is the basis of the cross-action on behalf of creditors and the action of the comptroller, which constitutes the basis of plaintiff's action? The claims are not mutual and cannot be offset against each other. The bank and its officers are not parties to the suit and can take nothing by it. They are, however, necessary parties to the determination of the question of fraud said to have been practiced by them and should have their day in court before judgment is awarded.

Western National Bank v. Armstrong, 152 U. S., 346, 354, 355.

In Houldsworth v. City of Glasgow Bank and Liquidators, 5 Ch. App., 387, the leading case in England on this subject, it was held that a person induced to buy stock in a banking association by fraudulent misrepresentations of its directors, could not, after the failure of the bank, maintain an action for damages against the liquidators (corresponding to the Receiver in our case) or against the bank.

Earl Cairns, L. C., said in deciding the case:

"I will assume that the allegations of frauduleut misrepresentations are such as that if the bank had been a going concern the appellant would have been entitled to rescind his contract and to have recovered back all sums paid in respect of his shares. The Court of Session has been of opinion that even although the averments amount to what I have stated, still they afford no ground for an action against the liquidators and they have dismissed the action. In my opinion the court is right. It was admitted before your Lordships, as indeed it could not be denied, that after the winding-up of the company commenced it was too late for the appellant to repudiate his stock, and that he must remain, as the liquidation found him, a partner in the bank and a contributory as such.

* * * It appears to have been contended in the court below that the appellant might be unable to maintain the present action as a claim in the liquidation to be satisfied *pari passu* with other creditors, and yet might be able to maintain it as a claim against shareholders in the company after all other creditors were satisfied. * * *

I am satisfied there is no foundation for it. [322, 323.]

"A man buys from a banking company shares or stock of such an amount as that he becomes, we will say, the proprietor of one-hundreth part of the capital of the company—a representation is made to him on behalf of the company that the liabilities of the company are £100,000 and no more. His contract, as between himself and those with whom he becomes a partner, is that he will be entitled to one-hundreth part of all the property of the company, and that the assets of the company shall be applied in meeting the liabilities of the company contracted up to the time of his joining them whatever their amount may be, and those to be contracted afterwards, and that if those assets are deficient the deficiency shall be made good by the shareholders rateably in proportion to their shares in the capital of the company. This is the contract and the only contract, made between him and his partners, and it is only through this contract and through the correlative contract of his partners with him that any liability of him or them can be enforced.

It is clear that among the debts and liabilities of the company to which the assets of the company and the contributions of the shareholders are thus dedicated by the contract of the partners, a demand that the company, that is to say, those same assets and contributions shall pay the new partner damages for a fraud committed on himself by the company, that is, by himself and his co-partners in

inducing him to enter into the contract which alone could make him liable for that fraud, cannot be intended to be included. Any such application of the assets and contributions would not be in accordance but at variance with the contract into which the new partner has entered."

* * * * * * * *

"If he succeds in that action this £4,000 will be paid out of the assets and contributions of the company. But he has contracted, and his contract remains, that the assets and contributions shall be applied in payment of the debts and liabilities of the company, among which, as I have said, this £4,000 could not be reckoned. The result is, he is making a claim which is inconsistent with the contract into which he has entered, and by which he wishes to abide; in other words, he is in substance if not in force, taking the course which is described as approbating and reprobating, a course which is not allowed either in Scotch or English law." [324, 325.]

The opinions of the other Lords are equally full and interesting, and the sum of the whole is that the only remedy of a person induced by fraudulent misrepresentations to purchase stock in a banking company is to rescind and tender back his stock before the company fails, or to bring his action of damages against the persons deceiving him. He cannot, after a failure of the bank, bring his action against the liquidators and recover *pari passu* with creditors of the bank, much less offset his claim against his liability as a stockholder.

In the case at bar it is not necessary to go so far, or to decide that plaintiff in error has no remedy against the bank or his fellow stockholders. It is only necessary to decide that he cannot, in this action, offset his claim for damages against his stockholder's liability, nor can he be permitted in an action to which the bank is not a party to recover a judgment against the bank which would entitle him to share *pari passu* with the bank's depositors in the assets of the bank.

These points have been considered and a very instructive opinion has been furnished by Judge Shiras, in the recent case of Sheafe v. Larimer, 79 Fed., 921, 923 to 924.

We quote from the syllabus:

"Where, upon the petition of a receiver of a State bank, an order has been made authorizing an assessment upon the capital stock of the bank under a statute authorizing such assessment (identical with the provision in the National Bank Act), the order is binding upon stockholders and cannot be collaterally attacked by them, although they were non-residents and not before the court.

"In such an action the defendant cannot plead as a counter-claim a claim for damages against the bank for false representations made at

the time he bought the stock, the bank not being a party to the action."

And from the opinion:

"Although the defendant set forth in the answer the facts relied upon as constituting false pretenses, a *rescission of the contract of sale is not prayed for, nor could it be properly sought for in this action, the same being at law.*" (p. 923.)

"The answer admits that in fact the defendant since October 1, 1891, has been a stockholder in the bank, but avers in substance, that he was induced to become a stockholder by means of certain false representations made to him by the president of that bank. The defendant has not sought nor secured a rescission of the contract of purchase of the stock by a degree in equity and he, therefore, is yet legally a stockholder and subject to the liabilities of a stockholder. The remedy sought in this action by the defendant is a judgment for damages and this is sought in the form of a counterclaim against the plaintiff and against the bank. The latter was not a party to the suit as originally brought and has not been served with notice, nor has an appearance therefor been entered. So far as the record now shows, the counterclaim is pending against the receiver only and I can see no ground for holding that the counterclaim can be sustained against the rights represented by the receiver in this case. The cause of action, if any exists, does not arise out of any acts of the receiver. * * * It is a claim for damages against the bank and it is open to the defendant to sue upon the claim for damages, and if judgment in his favor is obtained to file the claim as a debt with the receiver; but it cannot be availed of as a counterclaim against the receiver in the present action. (923–4). * * * * *

A stockholder cannot be permitted to set-off a debt due from the corporation to him, as against his stockholder's liability as that would be in effect to give him a preference over all creditors of the bank." (924–5).

Counsel for plaintiffs in error are, naturally, dissatisfied with this opinion and argue that it is unsupported by authority, is a mere *dictum*, etc. (brief p. —.) They cite passages from text books and numerous authorities to show how many remedies a party defrauded may pursue against the fraud feasor, but not one of them is to the point. Not one of them asserts the right of a stockholder, who has been induced by fraudulent representations to purchase his stock, to set up a counterclaim based on such fraud in a suit of this kind brought to enforce the stockholder's liability. Judge Shiras' opinion is supported by the authorities we have already cited and by the following:

Sawyer v. Hoag, 17 Wall., 610, 622.
Handley v. Stutz, 139 U. S., 417, 437.

Hobart v. Gould, 8 Fed., 57.
Wingate v. Orchard, 75 Fed., 241, 244.
Bausman v. Kinnear, 79 Fed., 172, 174, 175.
In re Empire City Bank, 18 N. Y., 199, 227.
Williams v. Traphagen, 38 N. J., Eq. 57.
Shickle v. Watts, 94 Mo., 410, 418.
Carbon Co. v. Mills, 78 In., 460, 465.
Thompson v. Bank, 19 Nev., 103, 114.
Buchanan v. Meisser, 105 Ill., 688, 643.

In Sawyer v. Hoag, 17 Wall., 624, the Court said, (to enable a party to make a set-off):

"The debt must be mutual; must be in the same right. The case before us is not of that character. The debt which the appellant owed for his stock was a trust fund devoted to the payment of all the creditors of the company. As soon as the company became insolvent and this fact became known to the appellant, the right of set-off for an ordinary debt to its full amount ceased. It became a fund belonging equally to all the creditors and could not be appropriated by the debtor to the exclusive payment of his own claim."

In Handley v. Stutz, 139 U. S., 437 the Court said:

"Under the case of Sawyer v. Hoag, 17 Wall., 610, Neely was clearly not entitled to set-off against the claim of the creditors his own claim against the corporation."

In Hobart v. Gould, 8 Fed., 57, Judge Nixon sustained a demurrer to a plea that the bank was indebted to the defendant in a sum in excess of the assessment and said, among other things:

"The demurrer raises the question whether such set-off is allowable; *i. e.*, whether a stockholder of a national bank, who happened also to be a creditor may cancel or diminish his assessment by off-setting his individual claim against the association. Considering the ends plainly in contemplation by the foregoing provisions of the statute, it would seem, upon principle, that no such escape from liability should be permitted by the shareholder. * * * *

"Besides, the right to a set-off in pleading is a creature of the statute, and applies only to mutual dealings and no such relations exist between the parties here. The liability to be enforced against the shareholder is not a debt due to the bank, but is a sum of money equal to the par value of his stock payable by him to the receiver as an officer of the government by force of the law and the assessment authorized and made by the comptroller."

In Wingate v. Orchard, 75 Fed., 241, the Circuit Court of Appeals of the Ninth Circuit refused to allow a stockholder to off-set

the amount of his deposits in the bank, and distinguished the case of Scott v. Armstrong, 146 U. S., 499.

In Bausman v. Kinnear, 79 Fed., 172, 174, the same court said:

"The unpaid stock is held to be a trust fund for the purpose of paying the debts of the corporation, and as such it must be distributed among the creditors *pro rata*. The debt due to a stockholder is entitled to no preference over other debts, and he cannot require its payment, by way of offset, to the exclusion or postponement of other claims. The reason usually assigned for this rule is that the debt owing by the stockholders to the corporation after insolvency, and that owing from the corporation to him, are not in the same right, the former being a debt payable to a trust fund. The decisions upon this proposition appear to be unanimous."

Cases Distinguished.

We do not dispute the right of a party defrauded to set up his counter-claim for damages in a suit brought against him by the other party to the contract; nor do we claim that insolvency and the appointment of a receiver for the other party will prevent his setting up such claim in an action by the receiver upon the same contract. We accept the cases cited by plaintiffs in error on these points as fair statements of the law.

The following cases, not so readily classified, are easily distinguished from the case at bar:

In Welles v. Stout, 38 Fed., 807, 810, Judge Shiras held that a set-off or counter-claim might be allowed in a suit by the receiver to enforce the stockholders' liability, where defendant laid claim to a special fund held by the bank in trust for a specific purpose, which fund had come into the hands of the receiver and in which the general creditors had no right. The reason for denying the right of set-off did not, in his judgment, apply to that case, for the claim was "*of such a nature that the holder thereof is entitled to receive the full amount thereof from the receiver before distribution in the way of dividends can be made to the general creditors.*" (p. 810.)

The same judge rendered the decision in Sheafe v. Larimer, 79 Fed., 921, showing that he had the distinction clearly in mind.

Zang v. Adams, 23 Col., 408, was a suit on a promissory note given to the bank, and the defense was a want of consideration for the note "arising out of the fraud of the company and no rights of innocent holders were involved." It was not a suit to enforce stockholders' liability.

Savage v. Bartlett, 78 Md., 561, was a suit for balance due on a stock subscription; not a suit to enforce stockholders' liability. Defendant subscribed for his stock July 7, '90, repudiated his contract January, '91, and the company made an assignment in April, '91.

The decision turned, in part, on the fact that defendant rescinded his contract before the assignment and, in part, upon the fact that the laws of Maryland do not provide for a registry of stockholders. (p.607.)

Florida Land & Improvement Co. v. Merrill, 52 Fed., 77, 81, and Robinson v. Dickey, 14 Tex. Civ. App., 70, 73, were suits in equity to rescind contracts of sale and to recover possession of real estate on the ground of fraud. In neither case was there an action to enforce stockholders' liability, and the court in each case disclaimed the right to interfere with any assessment on the stock of the bank which might be necessary to pay debts.

In Newton National Bank v. Newbegin, 74 Fed., 135, Newbegin brought suit to recover an amount paid by him for increased stock which was unauthorized and, therefore, void. In addition to this, the creditors agreed, after the suspension of the bank, to an extension of time and reorganization of the bank, while Newbegin's suit was pending, thus waiving their equities as against him.

In Stufflebeam v. De Lashmutt, 101 Fed., 357, the defendant set up in an amended answer that, in a suit brought by him in the state court against the president and secretary to rescind the contract of purchase by which he became possessed of stock and to compel a reconveyance of land deeded to the president in payment of the same and by him to the secretary, on the ground that the contract was induced by fraudulent misrepresentations, he obtained a decree in his favor. The court distinguishes the case from Lantry v. Wallace, 97 Fed., 869, (p. 371) and says: "The bank was insolvent at the time of his purchase and was closed by the Comptroller of the Treasury [sic.] so it is alleged some twenty days thereafter." * * * *

"I think the inference is warranted that no one other than the defendant himself was in any way prejudiced by the defendant's purchase of stock. It is not a question as to which of two innocent persons shall suffer loss." * * * * *

"The fact that De Lashmutt has a right to rescind his contract with Brune and compel a reconveyance of the land conveyed to the latter does not determine the question of the former's liability to creditors as a stockholder. De Lashmutt's right to relief against Brown and Brune is one thing; his liability to the creditors of the bank another." (372.)

Conclusion.

We submit that there is nothing in the voluminous argument of counsel for plaintiff in error, or in the authorities cited by them, to shake the general doctrine as applied by the court below.

We think that the following propositions of law are conclusively established by the authorities and that they are fatal to the contention of plaintiff in error, viz:

1. In an action of law brought by the receiver of a National Bank to recover the amount of a stockholder's liability, the stockholder cannot interpose the equitable defense that he was induced by the fraudulent misrepresentations of the bank's officers to purchase the stock.

2. It is not a defense to such an action that the stock held by the defendant was purchased by the bank from original stockholders, contrary to the statute, and then sold and transferred to defendant.

3. Whether or not defendant has a right of action for damages against the bank after its failure, for the fraudulent misrepresentation of its officers, he cannot set off the amount of his claim against his stockholder's liability, or recover judgment in a suit to which the bank itself is not a party.

Respectfully submitted,

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